BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

FILED
07-20-06
01:26 PM

Order Instituting Rulemaking on the Commission's own motion for the purpose of considering policies and guidelines regarding the allocation of gains from sales of energy, telecommunications, and water utility assets.	R.04-09-003

JOINT COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES AND THE UTILITY REFORM NETWORK ON ADMINISTRATIVE LAW JUDGE'S RULING REGARDING ALLOCATION OF GAINS ON SALE OF UTILITY ASSETS

Decision (D.) 06-05-041 deferred judgment on three issues that were not adequately supported by evidence in the record. Pursuant to above captioned Order Instituting Rulemaking ("OIR"), the Administrative Law Judge's ruling of June 29, 2006 in the above captioned proceeding the Division of Ratepayer Advocates ("DRA") and The Utility Reform Network ("TURN," collectively, "DRA/TURN") hereby file these Comments in the above captioned proceeding[1]

I. THE DEFINITION OF WHAT CONSTITUTES A "MAJOR FACILITY" ACROSS UTILITY INDUSTRIES SHOULD SEEK TO AVOID POTENTIAL "PIECEMEAL" AVOIDANCE OF REPORTING REQUIREMENTS

Section 455.5 of the Public Utilities Code requires that utilities report to the Commission when a "major facility" has remained out of service for nine consecutive months or longer. (Pub. Util. Code,[2] § 455.5, subd. (a).) That section does not, however, define the term "major facility," except to exclude "any facility determined by the

[1] In accordance with Rule 2.2(d), DRA has been authorized to sign these Joint Comments on behalf of TURN. TURN joins DRA only on Section I of these comments.

[2] All further statutory references shall be to the Public Utilities Code unless specified otherwise.

[C]ommission to constitute a plant held for future use." (§ 455.5, subd. (f).) The Commission thus seeks to define the parameters of major facilities so as to include all facilities across utilities which, if left in rate base while out of service, could lead to significant ratepayer overpayments.

The legislative intent behind 455.5 is clear in seeking to protect ratepayers from paying unreasonable rates caused by rate base changes associated with useless utility assets. The reporting requirements force the utilities to be conscientious about efficiently managing their assets. The Commission, however, rejected the initial reporting threshold of a purchase price greater than $500,000 because such a one-size-fits-all limit would exclude significant assets of smaller utilities, such as smaller water companies.[3] Major energy utilities companies also complained that the OIR's suggested $500,000 threshold value for section 455.5 reporting would be burdensome.[4] DRA/TURN agree that may be helpful or necessary to apply different figures for different size utilities.

DRA/TURN seek to ensure that larger transactions are not broken into smaller pieces in order to avoid the disallowance of expenses pursuant to section 455.5. In an analogous situation, the Commission ordered utilities to report on whether arguably related properties were being "piecemealed" in order to avoid Commission review of whether utility property was actually used and useful within the meaning of section 851.[5] Likewise, the exclusion of related, piecemealed facilities may in the aggregate cause substantial overpayments by ratepayers for the upkeep of unused property if related assets may be separated into units valued below the threshold dollar figure. Requiring the utilities to report whether unused facilities valued less than the cutoff price are arguably related to each other will mitigate such problems.

DRA/TURN are sensitive to the large utilities' concern regarding the substantial burden of reporting arising from a threshold set too low. Thus, the threshold may have to

---

[3] D.06-05-041.

[4] SCE's Opening Comments, p. 29; PG&E Opening Comments, pp. 21, 23; SDG&E and SoCalGas Opening Comments, p. 32.

[5] Resolution ALJ-186, filed August 25, 2005 at p. 5.

be established based on the size of the company. DRA/TURN, however, urge that the Commission require utilities to identify any facilities that may be related, and to confirm that no larger facilities are being piecemealed in order to avoid disallowance of expenses.

II. THE COMMISSION SHOULD SET AT ZERO THE RATE OF RETURN ON THE GAINS FROM THE SALE OF CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC) THAT ARE REINVESTED IN NEW WATER INFRASTRUCTURE

The Division of Ratepayer Advocates (DRA) recommends that the rate of return on gain derived from the sale of a CIAC asset and invested in new water infrastructure should be the same as that which is allowed on CIAC assets before sale, i.e., zero. The Commission has long held that because a CIAC asset is a gift to a water utility, it should be excluded from rate base. Consequently a water utility may not earn a rate of return on CIAC assets or recover it through rates. The CIAC asset remains a gift even when sold and the gain on sale is re-invested in new infrastructure. Nothing in Section 790 or its legislative history authorizes or warrants altering the ratemaking treatment of CIAC assets when they are sold. The Commission has discretion to set the appropriate rate of return consistent with the ratemaking treatment of CIAC.

Because a CIAC asset is treated as a gift to a water utility, the gain from the sale of a CIAC asset, and its reinvestment in new infrastructure, should remain unchanged -- as a gift or windfall to a water utility. This is a case of old wine in a new wine bottle. Before such a sale, the water utility has expended none of its own funds to acquire the CIAC asset and none of the gain on sale is a return of any water utility investment in the CIAC asset. The sale liquidates the CIAC asset, and any gain on sale is a windfall to the water utility, even if the gain is re-invested in a new infrastructure, i.e., the new wine bottle. Ratepayers should not have to reimburse a water utility for non-shareholder funded infrastructure or for gain on the sale of that gift.

The Commission has prohibited utilities from earning a profit on the investment of others, such as with CIAC assets:

> The Commission has reasoned that it is not specific property that has been invested in the public use but rather capital

> invested in the enterprise and it is that capital upon which the investor has the opportunity to earn a reasonable return. The Commission has authorized utility shareholders the opportunity to earn a reasonable return only on their own investment, not the investment of others. [Emphasis added.][6]

More specifically, the Commission holds that CIAC infrastructure is excluded from rate base and may not earn a rate of return, because it is not the investment of shareholders but from others:

> The Commission's policy against allowing utilities to earn on the investment of others is demonstrated in the regulatory treatment of contributions. Most often contributions are advances by developers seeking water service for their newly developed subdivision or they are connection fees or facility fees charged to individual customers seeking new water service. The treatment of developer advances or contributions are governed by Water Tariff Rule 15 or the Main Extension Rule, which originally applied to the extended distribution line(s) connecting to the water company. This rule was first developed in 1954 (D. 50580). It provided for refundable advances from prospective customers but expressly required that the financed extension line be excluded from rate base until, and in the precise amount, the advance was actually refunded. [Emphasis added.][7]

Therefore, the Commission should apply to the gain on sale from CIAC assets, the same rate of return as that authorized when the CIAC asset was given to the water utility, which is zero. Whether prior to sale as infrastructure or after sale as liquidated sales proceeds, the CIAC asset is a windfall to a water utility, which warrants its exclusion from rate base both before and after a sale.

---

[6] OIR re Government Financed Funding to Investor-Owned Water and Sewer Utilities, R. 04-09-002, 2004 Cal. PUC LEXIS 411, at * 4 n.1, (filed Sept. 2, 2004), *citing FPC v. Hope natural Gas Co.* (1944) 320U.S.591, 64 S.Ct.281*; Bluefield Water Works Co. v. Public Service Commission* (1923) 262U.S.679*; Duquesne Light Co. v Barash* (1989) 488 U.S.299, 109 S. Ct. 609.

[7] *Id.* at 2004 Cal. PUC LEXIS 411, at *6–*7.

III. SALES OF UTILITY ASSETS DUE TO CONDEMNATION OR THREAT OF CONDEMNATION SHOULD NOT FALL UNDER SECTION 790

In the case of *In re San Gabriel Water Co*., D. 04-07-034 (the *San Gabriel* decision), the Commission specifically held that the $2.6 million of condemnation proceeds received by the water utility and invested in replacement of a treatment plant are not subject to Section 790. In that case, the water utility had to take certain wells out of production because of contamination originating in the Mid-Valley Landfill operated by the County of San Bernardino (County). Under a 1998 settlement agreement, the County paid San Gabriel $ 8.6 million in settlement of (1) San Gabriel's claim of property damage to its water rights ($6 million), and (2) the cost of restoring lost well production ($2.6 million). The $ 2.6 million was used to construct a treatment facility at its Plant F-10 and restore the contaminated wells to service.[8]

San Gabriel claimed that Section 790 applies to all of the $8.6 million. However, other interested parties argued that because the County's $8.6 million settlement payment was intended to restore lost well production, Section 790 does not apply either to the $2.6 million or the $6 million portions of the total $8.6 million of condemnation proceeds.[9]

The Commission held,

> "We reject San Gabriel's argument that Section 790 applies to the $ 2.6 million cost of the treatment facility reimbursed by the County. As stated in the settlement agreement, the $ 8.6 million settlement payment includes the cost of a treatment facility to restore lost well production. Thus, the $ 2.6 million reimbursement for a new treatment facility needed to restore lost well production is not a Section 790 sale of real property that was no longer necessary or useful in the performance of the water corporation's duties to the public. Furthermore, there are no shareholder funds invested in the new treatment facility since San Gabriel was fully reimbursed by the County for the cost. For ratemaking purposes, we will treat the $ 2.6 million amount as a Contribution in Aid of Construction.

[8] Re *San Gabriel*, D.04-07-034; 2004 Cal. PUC LEXIS 334, at *71 – *73 (issued July 8, 2004)

[9] *Id.*

> Accordingly, we reduce ratebase by the $ 2.6 million reimbursement for the cost of the treatment plant, and will place that amount in the memorandum account related to such contamination costs."[10]

The Commission further found the record in the proceeding insufficiently addressed the ratemaking treatment of the remaining $ 6 million San Gabriel received from the County. The Commission ordered that the ratemaking issues pertaining to the $6 million should be addressed in the next GRC proceeding along with the other sale and condemnation proceeds received by San Gabriel since 1996 onwards. However, the Commission stated: "revenues related to these sale and condemnation proceeds will be subject to refund."[11]

Subsequently, the Commission reaffirmed its D. 04-07-034 holding in Ordering Paragraph 1 of D. 06-06-036, which states in pertinent part,

> "The rates and charges authorized by Decision 04-07-034 are subject to refund to the extent that they are based upon a rate base which includes plant purchased with funds received from: (A). . . (3) condemnations, and (4) inverse condemnations. . . . To the extent that financial gains were not the property of San Gabriel (and should have been allocated to ratepayers), but were invested in plant, those gains should be treated as CIAC."

///

///

///

[10] *Id.*

[11] *Id.*

Therefore based on D. 04-07-034 and D. 06-06-036, DRA requests that the Commission uphold its existing practice of barring Section 790 treatment for condemnation or inverse condemnation funds received by a water utility. Condemnation or inverse condemnation, and the proceeds received as a result, do not constitute a Section 790 sale of real property.[12]

Respectfully submitted,

/s/ ELIZABETH DORMAN

ELIZABETH DORMAN

Attorney for the Division of Ratepayer Advocates

California Public Utilities Commission
505 Van Ness Ave.
San Francisco, CA 94102
Phone: (415) 703-1415
Fax: (415) 703-2262
edd@cpuc.ca.gov

/s/ WILLIAM R. NUSBAUM

WILLIAM R. NUSBAUM

Attorney for The Utility Reform Network

711 Van Ness Avenue, Suite 350
San Francisco, California 94102
Phone: (415) 929-8876, x309
Fax: (415) 929-1132
bnusbaum@turn.org

July 20, 2006

[12] For that matter, an inverse condemnation under Section 1501 *et seq*., occurs when the government constructs water facilities that duplicate the facilities of a private water utility. Under § 1503, the private utility is entitled to compensation for the reduction in value of its property even where the government does not physically acquire the utility property. Thus, no sale of any kind, let alone a Section 790-type sale, has occurred.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **JOINT COMMENTS OF THE DIVISION AND THE UTILITY REFORM NETWORK ON ADMINISTRATIVE LAW JUDGE'S RULING REGARDING ALLOCATION OF GAINS ON SALE OF UTILITY ASSETS** in **R.04-09-003** by using the following service:

[X] **E-Mail Service:** sending the entire document as an attachment to an e-mail message to all known parties of record to this proceeding who provided electronic mail addresses.

[ ] **U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on July 20, 2006 at San Francisco, California.

/s/ ALBERT HILL
Albert Hill

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

* *

SERVICE LIST FOR R.04-09-003

pesposito@cbcatalysts.com
arizconway@msn.com
randy.sable@swgas.com
bridget.branigan@swgas.com
gottoson@bbko.com
leigh@parkwater.com
rdiprimio@valencia.com
eugene.eng@verizon.com
bobkelly@bobkelly.com
tjryan@sgvwater.com
ann.cohn@sce.com
janine.watkinsivie@sce.com
kswitzer@gswater.com.
gsullivan@sempra.com
jdriscoll@allenmatkins.com
cmanzuk@semprautilities.com
marcel@turn.org
mflorio@turn.org
rudy.reyes@verizon.com
bnusbaum@turn.org
edd@cpuc.ca.gov
jzr@cpuc.ca.gov
emery.borsodi@sbc.com
putzi@strangelaw.net
gregory.castle@sbc.com
gregory.castle@sbc.com
drimmer@strangelaw.net
mwaksman@att.com
michael.sasser@sbc.com
strange@strangelaw.net
ppv1@pge.com
gblack@cwclaw.com
jarmstrong@gmssr.com
smalllecs@cwclaw.com
jwiedman@gmssr.com
mschreiber@cwclaw.com
mmattes@nossaman.com
pschmiege@omm.com
smalllecs@cwclaw.com
lmcghee@calwater.com
palle_jensen@sjwater.com
jweil@aglet.org
rshortz@morganlewis.com

jacque.lopez@verizon.com
case.admin@sce.com
douglas.porter@sce.com
liddell@energyattorney.com
centralfiles@semprautilities.com
bob_loehr@yahoo.com
diane_fellman@fpl.com
bwt4@pge.com
cath@pge.com
FSC2@pge.com
rtp1@pge.com
kfugere@steefel.com
tmaiden@reedsmith.com
grady.mathai-jackson@lw.com
davidmarchant@dwt.com
judypau@dwt.com
tregtremont@dwt.com
cpuccases@pge.com
wbooth@booth-law.com
ceyap@earthlink.net
cborn@czn.com
bfs@cpuc.ca.gov
chc@cpuc.ca.gov
flc@cpuc.ca.gov
jef@cpuc.ca.gov
lwt@cpuc.ca.gov
mca@cpuc.ca.gov
srt@cpuc.ca.gov
smw@cpuc.ca.gov
sbh@cpuc.ca.gov